



Billing Code: 8025-01

SMALL BUSINESS ADMINISTRATION

13 CFR Parts 109, 115, 120, and 121

RIN: 3245-AG73

Affiliation for Business Loan Programs and Surety Bond Guarantee Program

AGENCY: Small Business Administration.

ACTION: Final rule.

SUMMARY: This final rule amends the regulations pertaining to the determination of size eligibility based on affiliation by creating distinctive requirements for small business applicants for assistance from the Business Loan, Disaster Loan and Surety Bond

Guarantee Program (“SBG”). For purposes of this rule, the Business Loan Programs consist of the 7(a) Loan Program, the Microloan Program, the Intermediary Lending Pilot Program (“ILP”), and the Development Company Loan Program (“504 Loan Program”).

Note: the Intermediary Lending Pilot Program was inadvertently left out of the proposed rule. There are currently intermediaries with revolving funds for eligible small businesses, so the program has been included in this final rule. The Disaster Loan Programs consist of Physical Disaster Business Loans, Economic Injury Disaster Loans, Military Reservist Economic Injury Disaster Loans, and Immediate Disaster Assistance Program loans. This rule redefines and establishes separate affiliation guidance applicable only to small business applicants in these Programs.

DATES: This rule is effective [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Dianna Seaborn, Office of Financial Assistance, Office of Capital Access, Small Business Administration, 409 Third Street SW, Washington, DC 20416; telephone 202–205–3645.

SUPPLEMENTARY INFORMATION:

I. Background

SBA is revising its regulations on affiliation for the Business Loan, Disaster Loan, and SBG Programs by separating and distinguishing the rules from the Agency’s government contracting, business development and other programs. This change streamlines the rules to comply with Executive Order 13563. This Executive Order “Improving Regulation and Regulatory Review,” provides that agencies “must identify and use the best, most innovative, and least burdensome tools for achieving regulatory ends.” (Emphasis added). Executive Order 13563 further provides that “[t]o facilitate the periodic review of existing significant regulations, agencies shall consider how best to promote retrospective analysis of rules that may be outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned.” (Emphasis added).

The loan programs authorized by the Small Business Act (Act), 15 U.S.C. 631 et seq., that are affected by this final rule are: (1) the 7(a) Loan Program authorized by Section 7(a) of the Act; (2) the Business Disaster Loan (“BDL”) Program authorized by Sections 7(b) and 42 of the Act; (3) the Microloan Program authorized by Section 7(m) of the Act; and (4) the ILP Program authorized by Section 7(l) of the Act. The 504 Loan Program, which is authorized by Title V of the Small Business Investment Act of 1958 (the “SBIA”), as amended, 15 U.S.C. 695 et seq., is also affected. Finally, this rule

affects the Surety Bond Guarantee (“SBG”) Program, authorized by section 411 of the SBIA. A detailed description of each program was included in the proposed rule.

On October 2, 2015, SBA published a proposed rule with request for comments in the Federal Register to identify changes to the rules on to simplify and streamline the application review process for the Business Loan, Disaster Loan, and SBG Programs. (80 FR 59667, October 2, 2015). These proposed affiliation changes apply only to applicants and not to SBA participants or CDCs in the programs. The comment period ended December 1, 2015.

II. Summary of Comments

The Agency received and reviewed the public comments on its affiliation rules for 13 CFR Parts 115, 120 and 121 in a proposed rule (80 FR 59667, October 2, 2015). The following narrative summarizes the comments reviewed and specifies the final rule changes regarding size standards based on principles of affiliation involving applicants to the Business Loan, Disaster Loan, and SBG Programs.

Size based on affiliation for applicants to the Business Loan, Disaster Loan, and SBG Programs will be addressed separately in a new §121.301(f) to distinguish them from affiliation requirements for government contracting, business development, and SBA’s other programs. These changes impact only the small business applicants and not lenders, CDCs, and surety bond companies.

SBA received 160 comments related to the proposed affiliation standards for the Business Loan, Disaster Loan, and SBG Programs. Of the comments received, 128 comments were from financial institutions (lenders and Certified Development Companies), 15 comments were from lender service providers, 4 comments were from

businesses (accounting and consulting firms), 7 comments were from trade associations, 3 comments were from law firms, 2 comments were from franchises, and 1 comment was from an individual that did not disclose an organizational type. All but 5 commenters indicated support for the majority of the proposed affiliation rule. There were 4 opposing comments related only to proposed changes to 121.301(f)(5), affiliation based on franchise and license agreements, and a 5th comment expressing concern about compliance regarding the affiliation rules for Surety Bonds in conjunction with federal contracts.

Thirty-four commenters requested modification of the defined management officials in §121.301(f)(1) and (f)(3).

Ninety-six commenters requested additional clarification in the language proposed defining who SBA includes for the identity of interest test in §121.301(f)(4), while 36 requested that it be eliminated in its entirety.

One hundred thirty-eight commenters supported changes to 121.301(f)(5), “Affiliation based on franchise and license agreements,” specifically requesting further modifications and clarity as to how SBA aggregates franchisees/licensees with franchisors/licensors as affiliates to determine whether the small business applicant (franchisee/licensee) is a small, independent business. The comments opposing franchise affiliation changes were received from a consulting group, an individual, a law firm, and one lender. These comments revolved around franchise disclosures and relationship issues under the jurisdiction of the FTC, and the lack of clarity

Thirty-seven commenters requested removal of the “totality of circumstances” analysis in §121.301(f)(6), while 92 commenters recommended examples and/or greater

clarity for when and how SBA will apply this analysis. SBA's responses to these comments are detailed in the following sections.

III. Section-by-Section Analysis of Comments and Changes

Section 109.20. In §109.20 Definitions, SBA proposes to include an amendment for the definition of Affiliate for the ILP Program from 13 CFR 121.103 to §121.301. SBA did not receive comments regarding this program as it is not currently funded.

Section 115.10. In §115.10 Definitions, SBA proposed to amend the definition of Affiliate for the SBG Program from the general 13 CFR 121 to the more specific § 121.301. One comment expressed concern about the potential necessity for small business contractors to comply with the affiliation rules for contracting, as well as the separate rules for Surety Bond Guarantees.

SBA data indicates that the significant majority of surety bond guarantees are for non-federal contracts which will benefit from this simplified rule. For the federal contract recipients, the existing contract rules will still apply, and if eligible thereunder, would also be eligible under this rule for the Surety Bond Guarantee. The provision is adopted as proposed.

Section 120.1700. Definitions used in subpart J. SBA proposed to amend the definition of Affiliate in §121.1700 for purposes of the First Lien Position 504 Loan Pooling Program. However, after further review, SBA determined that this affiliation rule for the Business Loan, Disaster Loan and Surety Bond Programs does not apply to 13 CFR 120.1700. SBA is not adopting the proposed change.

Section 121.103(a)(8). SBA proposed establishing the new §121.103(a)(8) to advise the public that the principles of affiliation for applicants in the Business Loan,

Disaster Loan and SBG Programs will be moved to a new §121.301(f). The final rule clarifies that §121.301(f) applies only to applicants for these specific programs.

Affiliation for SBA's other programs remains unchanged.

Section 121.301(f). SBA proposed establishing the new §121.301(f) where the principles for determining affiliation to qualify applicant business concerns as small, and therefore eligible to apply for the Business Loan, Disaster Loan, and SBG Programs would be located. The SBA has established this separate subsection because the analysis of affiliation under the Business Loan, Disaster Loan and Surety Bond Programs is different from the analysis for contracting programs. The affiliation guidance for all other SBA programs, including the government contracting and business development programs, remains unchanged.

Section 121.301(f)(1). SBA proposed establishing the new §121.301(f)(1) Affiliation Based on Ownership, where SBA would determine that control exists based on ownership when: (1) a person owns or has the power to control more than 50% of the voting equity of a concern; or (2) if no one person owns or has the power to control more than 50% of the voting equity of the concern, SBA would deem the small business to be controlled by either the President, Chairman of the Board, Chief Executive Officer (CEO) of the concern, or other officers, managing members, partners, or directors who control the management of the concern. A total of 155 commenters supported a change in the rule, with 34 of the commenters proposing further modification to limit the scope to only the President, CEO, Managing Partner, or Principal Manager. The comments for limiting scope were not adopted as it would not include all potential management and ownership organizational structures. Based on the elimination of the totality of circumstances, more

fully discussed in §121.301(f)(6), SBA proposes to include in this section that SBA finds control when a minority shareholder has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders. SBA is adopting the regulation with the inclusion of the Board and other shareholders.

Section 121.301(f)(2). SBA is establishing the new §121.301(f)(2) Affiliation arising under stock options, convertible securities, and agreements to merge, where SBA would duplicate language from §121.103(d). Other than duplicating the language in a different section of the regulation, SBA did not change the existing principles regarding affiliation arising under stock options, convertible securities, and agreements to merge currently found in §121.103(d). A total of 155 commenters supported keeping this the same, and repeating the language in §121.301(f)(2) for the Business Loan, Disaster Loan, and SBG Programs. There were no opposing comments. SBA is adopting the rule as proposed.

Section 121.301(f)(3). SBA proposed establishing the new §121.301(f)(3) Affiliation based on management, where SBA will utilize the same principles of affiliation for common management set forth in §121.103. Thirty-four commenters proposed limiting the scope of common management consideration to only the President, CEO, Managing Partner, or Principal Manager. Commenters did not include reasons for the requested elimination of Board members. SBA does not adopt the request for limiting scope, as they do not include consideration of all potential management organizational structures. In addition, SBA has modified the language to clarify that management agreements are included in the types of managers and management subject to

consideration under this regulation. Details on the types of management agreements that result in determinations of affiliation will be provided in SBA Loan Program Requirements. SBA is adopting the rule with refinements that include management by agreement.

Section 121.301(f)(4). SBA proposed establishing the new §121.301(f)(4) Affiliation based on identity of interest, where SBA would re-define the presumptions underlying the principles of establishing an identity of interest. The proposed rule provided that SBA would presume affiliation between two or more persons with an identity of interest, and the presumption could be rebutted with evidence showing that the interests are separate. The proposed rule provided further that SBA would presume an identity of interest between close relatives, as defined in 13 CFR 120.10. The proposed rule deviated from the existing rule in 13 CFR 121.103(f) by not specifically citing common investments and economic dependence as bases for finding an identity of interest. There were 155 commenters supporting a separate affiliation rule for identity of interest for the Business Loan and SBG Programs. Ninety-six commenters recommended additional clarity from SBA on the definition on “identity of interest,” as to the aggregation of unrelated parties and former employers. Thirty-six commenters requested elimination of the “identity of interest” regulation. SBA reviewed the language and disagrees with the request to eliminate the language related to identity of interest between close relatives, but otherwise agrees with the commenters’ suggestion to remove other bases for affiliation through identity of interest. SBA has revised the proposed rule by retaining identity of interest between close relatives but otherwise eliminating discussion of identity of interest for other reasons.

Section 121.301(f)(5). SBA proposed establishing the new §121.301(f)(5) Affiliation based on franchise and license agreements, where SBA proposed language that would limit franchise or license agreement reviews to the applicant franchisee or licensee and the franchisor, and not consider any franchise or license relationship of an affiliate of the applicant. A total of 138 commenters supported this change to SBA's treatment of franchisee affiliation with franchisors. The majority of commenters, however, expressed concern that the proposed rule was confusing, and others commented that the proposed rule did not go far enough to resolve the challenges and costs involved in the review of franchise relationships. Some commenters stated the proposed rule would not eliminate inconsistent determinations of franchise affiliation by SBA. Partnering with internal and external stakeholders, SBA made an extensive effort to better understand the burden imposed by existing processes, to identify relevant risks and to develop meaningful improvements. Along with public comments, SBA received specific comment from the office of Steve Chabot, Chairman of the House Small Business Committee, encouraging SBA to streamline and improve how best to address franchised business size relative to affiliation.

The current regulatory language in §121.103(f) recognizes that “the restraints imposed on a franchisee or licensee by its franchise or license agreement relating to standardized quality, advertising, accounting format, and other similar provisions, generally will not be considered in determining whether the franchisor or licensor is affiliated with the franchisee or licensee provided the franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership.” The current regulation continues, stating that “affiliation may arise, however, through other

means, such as common ownership, common management, or excessive restrictions upon the sale of the franchise interest.” Commenters indicated that SBA’s determination of the types of controls that do or do not constitute affiliation is not clear and is inconsistent with the overarching concept that many restraints are generally not considered when determining affiliation. Some commenters recommended that the regulation be amended to delete the provision that affiliation would be found based on restrictions in the agreement so long as the franchisee continues to have the right to profit from its efforts and bears the risk of loss commensurate with ownership. Additionally, many commenters recommended language be included in the regulatory text to clarify SBA’s intent to only review agreements of the “applicant” and not review any agreements of affiliated entities. These commenters recommended adding language to the regulatory text similar to what was included in the Supplementary Information in the proposed rule.

Based on the volume of comments received in the current and previous rulemaking requests, and to provide consistency in its application of the principles of affiliation involving franchise or license agreements, SBA is removing regulatory text that only addressed certain types of restraint. The regulatory changes clarify that SBA does not consider that franchise or license relationships create affiliation, provided the franchisee/licensee has the right to profit from its efforts, and bears the risk of loss commensurate with ownership. SBA will provide guidance on the franchisee/licensee’s right to profit from its efforts and bear the risk of loss commensurate with ownership in its Standard Operating Procedure (SOP) 50 10.

SBA also is adding a sentence to the end of the regulatory text to clarify its intent that only franchise or license relationships of the applicant will be considered, not those of any of the applicant's affiliates.

Section 121.301(f)(6). SBA proposed establishing the new §121.301(f)(6) Affiliation based on SBA's determination of the totality of circumstances, where SBA proposed to retain finding of affiliation based on the totality of circumstances similar to the regulations currently found in §121.103(a)(5). There were 97 commenters requesting elimination of this rule, and 37 commenters indicated that including this requirement as a factor for determining affiliation would contravene SBA's stated intent of providing a bright line test of affiliation. Commenters requested examples of when SBA would apply the test so that participants could better understand how this factor would impact eligibility decisions. SBA reviewed and considered the concerns identified regarding the potential overarching but undefined aggregation of circumstances. SBA agrees that the prior rules in proposed §121.301(f)(1) – (5) and (7) – (8) provide specificity. Generally examples reviewed are negative control, and control through management agreement. Rather than include examples here, SBA is removing the totality of the circumstances criterion, but provides specific guidance in §121.301(f)(1) and (f)(3) to address negative control, and control through management agreements that would have been included in this section. SBA agrees with the commenters' suggestions and will remove this paragraph from the final rule. Therefore proposed §121.301(f)(7) and (f)(8) are renumbered §121.301(f)(6) and (f)(7).

Section 121.301(f)(7). SBA proposed establishing the new §121.301(f)(7) Determining the concern's size, where SBA states that SBA counts receipts, employees,

or alternate size standards of a concern and its affiliates. There were no specific objections regarding this provision. SBA is adopting the rule as proposed, and renumbered as §121.301(f)(6).

Section 121.301(f)(8). SBA proposed establishing the new §121.301(f)(8) Exceptions to affiliation, where SBA would incorporate the exceptions to affiliation set forth in 13 CFR 121.103(b). There were no specific objections regarding this provision. The proposed rule is adopted as written, and renumbered as §121.301(f)(7).

Finally, SBA proposed not to apply several current principles of affiliation that apply in the federal contracting and business development programs to the Business Loan, Disaster Loan, and SBG Programs. Specifically, SBA proposed to eliminate applying affiliation based on a newly organized concern (see §121.103(g)) and joint ventures (see §121.103(h)). One purpose of the newly organized concern rule is to prevent former small businesses from creating spin-off companies in order to continue to perform on small business contracts or receive other contracting benefits. While this affiliation principle is appropriate for federal contracting, it is generally not applicable to the Business Loan, Disaster Loan, or SBG Programs. The only responsible party or parties for an SBA loan are the owners or guarantors executing debt instruments on behalf of the applicant business. Generally, former employers of small business applicants are not obligors nor are they guarantors on extensions of credit to SBA applicants. There were no specific objections to the elimination of newly organized concerns or joint ventures as affiliates for purposes of these programs. SBA adopts the proposed exclusion from the rule on affiliation for the Business Loan, Disaster Loan, and SBA Programs.

With respect to joint ventures, these partnerships form when two or more businesses combine their efforts in order to perform on a federal contract or receive other contract assistance. SBA does not consider affiliation based on the joint venture to be of significant concern to the Business Loan or Disaster Loan Programs because a loan to any joint venture will require all members of the joint venture to accept full responsibility for loan guarantee liability. Also, agency records indicate that applicants for assistance under SBA Business Loan and Disaster Loan Programs are rarely, if ever, joint ventures, and, therefore, this provision is unnecessary. For the Surety Bond Guarantee Program, the guarantee is on the bond, not a contract. In any joint venture where the surety company requests a bond guarantee, each member of the joint venture is required to accept full responsibility for the bond guarantee liability.

SBA also proposed to omit “negative control” as a stand-alone factor in determining affiliation for the purpose of loan eligibility. Pursuant to 13 CFR 121.103(a)(3), negative control may exist where a minority shareholder can block certain actions by the board of directors. SBA received many comments requesting clarity or removal of §121.301(f)(6) Affiliation based on SBA’s determination of the totality of circumstances. SBA agreed to the removal of §121.301(f)(6), and included additional specific guidance as to negative control through minority ownership and by management agreement in §121.301(f)(1) and (f)(3) respectively.

IV. Compliance With Executive Orders 12866, 13563, 12988, and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35.), and the Regulatory Flexibility Act (5 U.S.C. 601–612)
Executive Order 12866

The Office of Management and Budget (OMB) has determined that this final rule is a “significant” regulatory action for the purposes of Executive Order 12866.

Accordingly, the next section contains SBA’s Regulatory Impact Analysis. However, this is not a major rule under the Congressional Review Act, 5 U.S.C. 800.

Regulatory Impact Analysis

1. Is there a need for this regulatory action?

The Agency believes it needs to reduce regulatory burdens and expand its Business Loan, Disaster Loan, and SBG Programs by streamlining delivery, lowering costs, and facilitating job creation. As noted above, responses received from the Federal Register proposed rule notice regarding SBA rules on affiliation were in favor of simplified rules that enhance understanding and align with normal commercial industry practices. Specifically of the 160 commenters for the proposed rule on affiliation, 4 comments were from businesses (accounting and consulting firms), 3 comments were from law firms, and 1 comment was from an individual that did not disclose their organizational type. All of the small business comments showed support for the affiliation rule. Small business applicants will be assisted by this streamlining of requirements because it will be easier and more cost effective for a lender to research whether the applicant small business controls or is controlled by large companies which would jeopardize their eligibility. Higher lender costs potentially result in greater costs to the applicant small business. No comments were received from small businesses on the regulatory impact analysis during the proposed rule comment period.

2. What are the potential benefits and costs of this regulatory action?

This rule will eliminate unnecessary cost burdens on loan applicants' and lenders' participation in SBA-guaranteed loans. This final rule exempts the Business Loan, Disaster Loan, and SBG Programs from certain government contracting rules that determine whether an entity is deemed affiliated with an applicant. These general affiliation rules apply to federal contracting to ensure that small businesses (and not another entity) receive and perform a federal contract when a preference for small businesses is provided. Many of these general principles of affiliation (e.g., newly organized concern) are not applicable to the Business Loan, Disaster Loan, or SBG Programs. SBA reviewed five years of data from the SBA Loan Guaranty Processing Center. The data specifically tracked reasons each loan would have been screened out. During the five-year period, based on the screen out reasons specific to affiliation, 1,379 small businesses failed to submit affiliate financials, and 1,363 needed clarifications or additional information to complete processing. SBA has determined that the proposed simplification of size based on affiliation will eliminate confusion, and save time and costs for the small business applicants and the lenders. Additionally this regulatory action will improve SBA processing efficiency and turnaround times.

3. What alternatives have been considered?

As indicated above, on October 2, 2015, the Agency issued a proposed rule for comment in the Federal Register to identify several changes intended to reinvigorate the Business Loan, Disaster Loan, and SBG Programs by eliminating unnecessary compliance burdens and loan eligibility restrictions. The Agency previously published in the Federal Register on February 25, 2013, a prior proposed rule for comment on 7(a) and 504 loan program requirements which had also included proposed changes to the

affiliation rules for loan programs. See Proposed Rule: 504 and 7(a) Loan Programs Updates, 78 FR 12633 (February 25, 2013). Included in these proposals was an alternate affiliation definition. After a full comment period ending April 26, 2013, and careful consideration of all comments, SBA decided to further deliberate and consider issues of redefining affiliation for the Business Loan Programs and SBG Program. As a result, no changes were adopted regarding affiliation in the 7(a) and 504 loan program final rule. See Final Rule: 504 and 7(a) Loan Programs Updates, 78 FR 15641 (March 21, 2014).

This final rule presents a set of requirements to determine affiliation based on the precedent separating the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs from the government contracting standards. SBA has reviewed extensive public comments and suggestions in developing this final rule and considered changes needed to mitigate identified economic risk to the taxpayers and reduce waste, fraud, and abuse.

Executive Order 13563

A description of the need for this regulatory action and benefits and costs associated with this action, including possible distributional impacts that relate to Executive Order 13563, are included above in the Regulatory Impact Analysis under Executive Order 12866. The Business Loan Programs operate through the Agency's lending partners, which are 7(a) Lenders for the 7(a) Loan Program, Intermediaries for the Microloan Program and ILP Program, and CDCs for the 504 Loan Program. The Agency participated in public forums and meetings with NAGGL board members and program participants at industry conferences from the Fall of 2014 through Spring of 2015 which allowed it to reach trade associations and hundreds of its lending partners

from which it gained valuable insight, guidance, and suggestions. The Agency's outreach efforts to engage stakeholders before proposing this rule was extensive, and concluded with the comment period.

Executive Order 12988

This action meets applicable standards set forth in Sections 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action does not have retroactive or preemptive effect.

Executive Order 13132

SBA has determined that this final rule will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government.

Therefore, for the purposes of Executive Order 13132, SBA has determined that this final rule has no federalism implications warranting preparation of a federalism assessment.

Paperwork Reduction Act, 44 U.S.C. Ch.35

The SBA has determined that this final rule would not impose additional reporting and recordkeeping requirements under the Paperwork Reduction Act (PRA). In fact, those individuals and entities that SBA considers potential affiliates has been refined and reduced for the Business Loan, Disaster Loan, and the SBG Programs, which could result in reduced reporting and recordkeeping. Participants in SBA's 7(a) Loan Program will continue to report any affiliates of their business on SBA Form 1919 (OMB Control No. 3245-0348), and participants in SBA's 504 Loan Program will continue to report affiliates on SBA Form 1244 (OMB Control No. 3245-0071). EIDL Program participants will continue to report affiliates on SBA Form 5 (OMB Control No. 3245-0017), and

SBG Program participants will continue to report affiliates on SBA Form 994 (OMB Control No. 3245–0007).

Regulatory Flexibility Act, 5 U.S.C. 601– 612

When an agency issues a rulemaking, the Regulatory Flexibility Act (RFA), 5 U.S.C. 601-612, requires the agency to “prepare and make available for public comment a final regulatory analysis” which will “describe the impact of the final rule on small entities.” Section 605 of the RFA allows an agency to certify a rule, in lieu of preparing an analysis, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities.

The rulemaking will positively impact all of the approximately 4,000 7(a) Lenders (some of which are small), 35 Intermediary Lending Pilot lenders, approximately 260 CDCs (all of which are small), 145 Microloan Intermediaries, and 23 Sureties in the SBG Program. The final rule will reduce the burden on program participants. SBA has determined that the streamlining of certain program process requirements through this modification of eligibility based on affiliation will present no adverse or significant impact, including costs for the small business borrower, lender, or CDC. This proposal presents a best practice rule that removes unnecessary regulatory burdens, increases access to capital for small businesses and facilitates American job preservation and creation. SBA has determined that there is no significant impact on a substantial number of small entities.

Small business applicants will be assisted by this streamlining of requirements because it will be easier and more cost effective for lenders to identify whether applicant small businesses control or are controlled by other companies that would jeopardize

eligibility. SBA reviewed five years of data from the SBA Loan Guaranty Processing Center. The data specifically tracked reasons for loan screen outs that delayed processing. During the five-year period based on the screen out reasons specific to affiliation, the processing was delayed for over 2,600 loan applicants. SBA believes that the proposed simplified rules on affiliation provide participants with needed clarity that results in reduction of the paperwork and review time required to make accurate determinations. The time/cost benefit for business applicants and participants is substantial. Additionally this regulatory action will improve SBA processing efficiency and turnaround times.

The SBA Administrator certified to the Chief Counsel for Advocacy of the SBA that this rule, if adopted, would not have a significant economic impact on a substantial number of small entities. As such, the Chief Counsel certifies that this rule will not have a significant impact on a substantial number of small entities.

List of Subjects

13 CFR Part 109

Community development, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

13 CFR Part 115

Claims, Reporting and recordkeeping requirements, Small businesses, Surety bonds.

13 CFR Part 120

Individuals with disabilities, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

13 CFR Part 121

Grant programs-business, Individuals with disabilities, Loan programs-business, Small businesses.

For the reasons stated in the preamble, the Small Business Administration amends 13 CFR parts 109, 115, 120, and 121 as follows:

PART 109 – INTERMEDIARY LENDING PILOT PROGRAM

1. The authority citation for 13 CFR part 109 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6), (b)(7), and 636(1).

2. Amend §109.20 to revise the definition of “Affiliate” to read as follows:

§109.20 Definitions

Affiliate is defined in § 121.301(f) of this chapter.

* * * * *

PART 115 – SURETY BOND GUARANTEE

3. The authority citation for 13 CFR part 115 continues to read as follows:

Authority: 5 U.S.C. app 3; 15 U.S.C. 687b, 687c, 694a, 694b note; and Pub. L. 110-246, Sec. 12079, 122 Stat. 1651.

4. Amend §115.10 to revise the definition of "Affiliate" to read as follows:

§115.10 Definitions.

Affiliate is defined in §121.301(f) of this chapter.

* * * * *

PART 120 – BUSINESS LOANS

5. The authority citation for 13 CFR part 120 continues to read as follows:

Authority: 15 U.S.C. 634(b)(6), (b)(7), (b)(14), (h), and note, 636(a), (h), and (m), 650, 687(f), 696(3), and 697(a) and (e); Pub. L. 111-5, 123 Stat. 115, Pub. L. 111-240, 124 Stat. 2504.

6. Revise the first sentence of §120.151 to read as follows:

§120.151 What is the statutory limit for total loans to a Borrower?

The aggregate amount of the SBA portions of all loans to a single Borrower, including the Borrower's affiliates as defined in §121.301(f) of this chapter, must not exceed a guaranty amount of \$3,750,000, except as otherwise authorized by statute for a specific program. ***

PART 121 – SMALL BUSINESS SIZE REGULATIONS

7. The authority citation for 13 CFR part 121 continues to read as follows:

Authority: 15 U.S.C. 632, 634(b)(6), 662, and 694a(9).

8. Amend §121.103 to add paragraph (a)(8) to read as follows:

§121.103 How does SBA determine affiliation?

(a) * * *

(8) For applicants in SBA's Business Loan, Disaster Loan, and Surety Bond Guarantee Programs, the size standards and bases for affiliation are set forth in §121.301.

* * * * *

9. Amend §121.301 to revise the section heading and to add paragraph (f) to read as follows:

§121.301 What size standards and affiliation principles are applicable to financial assistance programs?

* * * * *

(f) Concerns and entities are affiliates of each other when one controls or has the power to control the other, or a third party or parties controls or has the power to control both. It does not matter whether control is exercised, so long as the power to control

exists. Affiliation under any of the circumstances described below is sufficient to establish affiliation for applicants for SBA's Business Loan, Disaster Loan, and Surety Bond Programs. For this rule, the Business Loan Programs consist of the 7(a) Loan Program, the Microloan Program, the Intermediary Lending Pilot Program, and the Development Company Loan Program ("504 Loan Program"). The Disaster Loan Programs consist of Physical Disaster Business Loans, Economic Injury Disaster Loans, Military Reservist Economic Injury Disaster Loans, and Immediate Disaster Assistance Program loans. The following principles apply for the Business Loan, Disaster Loan, and Surety Bond Guarantee Programs:

(1) Affiliation based on ownership. For determining affiliation based on equity ownership, a concern is an affiliate of an individual, concern, or entity that owns or has the power to control more than 50 percent of the concern's voting equity. If no individual, concern, or entity is found to control, SBA will deem the Board of Directors or President or Chief Executive Officer (CEO) (or other officers, managing members, or partners who control the management of the concern) to be in control of the concern. SBA will deem a minority shareholder to be in control, if that individual or entity has the ability, under the concern's charter, by-laws, or shareholder's agreement, to prevent a quorum or otherwise block action by the board of directors or shareholders.

(2) Affiliation arising under stock options, convertible securities, and agreements to merge. (i) In determining size, SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the power to control a concern. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.

(ii) Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered “agreements in principle” and are thus not given present effect.

(iii) Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.

(iv) An individual, concern or other entity that controls one or more other concerns cannot use options, convertible securities, or agreements to appear to terminate such control before actually doing so. SBA will not give present effect to individuals', concerns', or other entities' ability to divest all or part of their ownership interest in order to avoid a finding of affiliation.

(3) Affiliation based on management. Affiliation arises where the CEO or President of the applicant concern (or other officers, managing members, or partners who control the management of the concern) also controls the management of one or more other concerns. Affiliation also arises where a single individual, concern, or entity that controls the Board of Directors or management of one concern also controls the Board of Directors or management of one of more other concerns. Affiliation also arises where a single individual, concern or entity controls the management of the applicant concern through a management agreement.

(4) Affiliation based on identity of interest. Affiliation arises when there is an identity of interest between close relatives, as defined in 13 CFR 120.10, with identical or substantially, identical business or economic interests (such as where the close relatives

operate concerns in the same or similar industry in the same geographic area). Where SBA determines that interests should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate.

(5) Affiliation based on franchise and license agreements. The restraints imposed on a franchisee or licensee by its franchise or license agreement generally will not be considered in determining whether the franchisor or licensor is affiliated with an applicant franchisee or licensee provided the applicant franchisee or licensee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. SBA will only consider the franchise or license agreements of the applicant concern.

(6) Determining the concern's size. In determining the concern's size, SBA counts the receipts, employees (§121.201), or the alternate size standard (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.

(7) Exceptions to affiliation. For exceptions to affiliation, see 13 CFR 121.103(b).

Maria Contreras-Sweet,
Administrator.

[FR Doc. 2016-14984 Filed: 6/24/2016 8:45 am; Publication Date: 6/27/2016]